Supreme Court, U.S.
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No. 96-708

In The

# Supreme Court of the United States

October Term, 1996

THE GREENE COUNTY BANK,

*Petitioner,*

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,

*Respondent.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit**

## PETITIONER'S REPLY BRIEF

CHARLES W. GERMAN
*Counsel of Record*
BRANT M. LAUE
JOEL P. FAHNESTOCK
ROUSE, HENDRICKS, GERMAN, MAY & SHANK, P.C.
1010 Walnut Street, Suite 400
Kansas City, MO 64106
(816) 471-7700

*Counsel for Petitioner*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ..... ii

CONCLUSION ..... 6

# TABLE OF AUTHORITIES

Page

CASES

*First Nat'l Bank of Eden v. Department of the Treasury*, 568 F.2d 610 (8th Cir. 1978) ..... 2

*Gulf Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982) .....1, 2, 3, 4

*Hoffman, v. FDIC*, 912 F.2d 1172 (9th Cir. 1990) .....2, 3

*Johnson v. Office of Thrift Supervision*, 81 F.3d 195 (D.C. Cir. 1996).....2, 3

*Oberstar v. FDIC*, 987 F.2d 494 (8th Cir. 1993)..... 2

*Seidman v. Office of Thrift Supervision*, 37 F.3d 911 (3d Cir. 1994) .....2, 3

OTHER AUTHORITIES

12 U.S.C. § 1818(b) .....1, 3, 4, 5

12 U.S.C. § 1818(e) ..... 4

## PETITIONER'S REPLY BRIEF

This reply brief is submitted by The Greene County Bank in support of its petition for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit. Respondent FDIC concedes that a conflict among the circuit courts has developed over the last eighteen years concerning the meaning of the term "unsafe and unsound" in 12 U.S.C. § 1818(b), but urges the Court to decline review because the conflict may resolve of its own accord given more time. This FDIC position denigrates the importance of this core issue of financial institution regulation, and is highly speculative and unlikely. This case is an appropriate one for this Court's resolution of the admitted conflict in the appellate courts.

1. All of the many financial institution regulatory agencies apply the "unsafe and unsound" standard on a daily basis in countless contexts. The appellate courts reviewing the scope of the "unsafe and unsound" standard have adopted two fundamentally different views of the circumstances which warrant regulatory intrusion into a bank's operations through an enforcement action, and that is what warrants review by this Court.

The Fifth Circuit's decision in *Gulf Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982), provided an authoritative construction of the statutory "unsafe and unsound" standard, holding that it referred to "practices that threaten the financial integrity" of the bank. 651 F.2d at 267. The Eighth Circuit, on the other hand, divined a less rigorous and speculative standard for "unsafe and unsound" which asks only whether a challenged banking

practice "might result in abnormal risk or loss." *First Nat'l Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611 n.2 (8th Cir. 1978).

In the 1990's, faced with increased regulatory litigation and the resulting task of defining the scope of the statutory standard, the Third Circuit, the District of Columbia Circuit, and seemingly the Ninth Circuit as well, adopted the Fifth Circuit's *Gulf Federal* formulation. *Seidman v. Office of Thrift Supervision*, 37 F.3d 911, 928 (3d Cir. 1994); *Johnson v. Office of Thrift Supervision*, 81 F.3d 195, 204 (D.C. Cir. 1996);[1] *Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990). The Eighth Circuit, however, adopted its own earlier *Bank of Eden* precedent in *Oberstar v. FDIC*, 987 F.2d 494, 502 (8th Cir. 1993). This less rigorous Eighth Circuit legal standard was then applied against the Petitioner in this case. Pet. App. 6a.

This is not a minor conflict in the circuit courts, but rather one that involves a legal standard which all financial institutions, their regulators, and increasingly the lower courts, must deal with constantly. Nor is this conflict, as suggested by the FDIC (FDIC Br. 9-10), one that will likely resolve itself. This split in the circuit courts developed over eighteen years (1978-1996), a lengthy period which does not suggest that the conflict will go away of its own accord. Indeed, the FDIC's argument is that the Fifth, Third, District of Columbia, and Ninth Circuits will in effect overrule themselves and follow the Eighth Circuit's lead "upon a full airing of the issue." *Id.*

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[1] In *Johnson*, the Office of Thrift Supervision appears to have accepted the higher standard. 81 F.3d at 201 n.8, 204. That regulatory position is at odds with the FDIC position here.

If the FDIC's suggestion were ever a reasonable scenario, the *Seidman*, *Hoffman*, and *Johnson* courts would have adopted the Eighth Circuit's earlier *Oberstar* and *Bank of Eden* reasoning. That these courts instead chose the Fifth Circuit's *Gulf Federal* standard demonstrates that continued conflict is inevitable.[2] The only "full airing of the issue" that can resolve these significant differences on a recurring and important statutory issue is review by this Court.

2. The FDIC's criticism of the *Gulf Federal* standard as a "restrictive judicial gloss" (FDIC Br. 12), is unpersuasive. Protection of a financial institution's economic stability, and thus against the risk of loss to federal insurance and bank depositors, is the fundamental purpose for having regulatory agencies with broad oversight powers, and the *Gulf Federal* standard does no more than recognize that financial instability is the keystone for finding an "unsafe and unsound" banking practice. The examination process gives the regulatory agencies virtually unfettered access into all aspects of a bank's operations and performance. Most disagreements are resolved during the examination process. If an agency brings formal enforcement proceedings, however, seeking as in this case a court judgment imposing even greater regulatory control, it is sensible and consistent with the congressional intent in 12 U.S.C. § 1818(b) to base such a judgment on a "reasonably direct effect on an association's

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[2] The District of Columbia circuit described the *Gulf Federal* standard as illustrative of "the weight of case law," *Johnson*, 81 F.3d at 204, a statement which does not suggest that the courts will be moving over time to the Eighth Circuit's lower standard.

financial soundness." *Gulf Federal*, 651 F.2d at 264. This is an issue worthy of full consideration and review in this Court.

The FDIC's attempt to contrast cease and desist proceedings under 12 U.S.C. § 1818(b) with removal/prohibition proceedings under 12 U.S.C. § 1818(e) is similarly unpersuasive. This was not the rationale adopted by the Eighth Circuit. Pet. App. 6a. Moreover, that Congress has provided that even greater harm must be shown by the regulatory agency to justify depriving a person of the ability to pursue a chosen avocation than to justify a cease and desist order is hardly a startling legislative choice, but this difference in the two kinds of cases provides no statutory answer to the question on which the circuit courts have split. This issue also deserves "full airing" in this Court.

The FDIC's argument (FDIC Br. 13) that the *Gulf Federal* standard, requiring a reasonably direct threat to financial soundness, cannot be reconciled with the recognized ability to base a cease and desist order on a technical statutory or substantive regulatory violation is again off the mark. The Eighth Circuit did not articulate this theory. Pet. App. 6a. Financial institutions are on fair notice of statutory and regulatory requirements. They are not on fair notice under the Eighth Circuit's speculative standard of what might be considered an "unsafe and unsound" banking practice. This argument also suggests that review in this Court is appropriate.

3. Finally, the FDIC argues (FDIC Br. 14-15) that petitioner would lose this case even under the *Gulf Federal* legal standard. That argument is plainly wrong.

The Administrative Law Judge ("ALJ") found specifically that the petitioner's hedging program did not expose the institution to any abnormal risk of loss. *See, e.g.*, Pet. App. 92a-93a. The ALJ also found compliance in all material respects with the Memorandum of Understanding ("MOU"). Pet App. 94a-95a, 99a.[3] It was only the "recordkeeping" deficiencies that were relied on by the FDIC, Pet. App. 127a-128a, and by the Eighth Circuit, Pet. App. 4a-5a, in affirming issuance of a penalizing cease and desist order under 12 U.S.C. § 1818(b). There is nothing but speculation that these regulatory paperwork complaints could ever pose an abnormal risk to the overall financial stability of the institution, the legal standard in the Fifth, Third, and District of Columbia Circuits, and probably the Ninth Circuit as well. The petitioner is located in the Eighth Circuit, an irrelevant geographic factor which has subjected it to onerous regulatory proceedings that would never have occurred elsewhere in the country. Only review by this Court can address and resolve this admitted conflict among the circuit courts.

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[3] The ALJ noted the differing legal standards, but held that the banking matters complained of by the FDIC did not meet any standard for "unsafe and unsound" practices. Pet. App. 52a-53a.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

ROUSE, HENDRICKS, GERMAN,
MAY & SHANK, P.C.

CHARLES W. GERMAN
MO Bar #26534
*Counsel of Record*
BRANT M. LAUE MO Bar #36952
JOEL P. FAHNESTOCK MO Bar #42698
One Petticoat Lane Building
1010 Walnut Street, Suite 400
Kansas City, MO 64106
Tele: (816) 471-7700
Fax: (816) 471-2221

*Attorneys for Petitioner*
*The Greene County Bank*